

The California Cemetery Board:

**Incompatible Activities and Breaches of
Fiduciary Duties Over Cemetery Trust Funds**

January 1996
I950038

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CALIFORNIA STATE AUDITOR

January 17, 1996

Investigative Report I950038

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

Pursuant to the Reporting of Improper Governmental Activities Act, the Bureau of State Audits presents its investigative report concerning incompatible activities and breaches of fiduciary duties at the California Cemetery Board.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

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Summary

We received an allegation under the Reporting of Improper Governmental Activities Act that an official of the California Cemetery Board (board) was involved in activities that conflicted with his state duties at the board. The complainant also alleged that the official breached his fiduciary duties when administering cemetery trust funds.

We investigated and substantiated these and other improper governmental activities. Specifically, we found the following illegal or improper activities by two board employees:

- The board official illegally accepted more than \$10,200 from a licensee who was subject to the board's regulation.
- The official made false representations and withheld information from us concerning a cemetery that belonged to the same licensee.
- The official improperly told the licensee that the cemetery was excluded from statutory requirements.
- Another board employee violated state law when he accepted \$3,840 from a cemetery under court-ordered receivership.

In addition, we found the following violations of the official's fiduciary duties for cemetery trust funds:

- He spent \$6,426 of Arlington Cemetery's trust funds for illegal and improper purposes.
- Without court authorization, he spent portions of the principal of Arlington Cemetery's trust.
- He failed to identify Arlington Cemetery's property as trust property.

- He failed to invest other cemetery trust funds prudently and prepare accounting documents as required by law and failed to follow prudent administrative procedures when investing cemetery trust funds.

The Department of Consumer Affairs (department) has taken the following corrective actions:

- Because the statutory authorization for the official's position ended January 1, 1996, the department terminated his position as of that date and will not offer him another position.
- The department will continue its investigation into the official's and his wife's personal use of Arlington Cemetery trust funds in cooperation with other law enforcement agencies and will seek criminal action if appropriate.
- The department will recover misused Arlington Cemetery trust funds either through criminal or civil actions.
- The department will refer conflict of interest issues to the Fair Political Practices Commission.
- The department terminated the other employee's limited-term appointment and will explore recovering payments made to him as appropriate.
- The department will assure that payments to the other employee are properly reported to taxation authorities.
- The department has gained control of the majority of the trust funds, has reconciled accounts, is preparing an investment strategy, and has established systems of internal control over the accounts, including separating the various duties related to administering the funds.
- The department does not agree that the trust funds must be deposited with the state treasurer. As stated in the report, if the department obtains permission from the Department of Finance, it can deposit the funds outside the state treasury. The department also is concerned whether depositing funds in the treasury will afford the flexibility necessary to disburse funds for appropriate cemetery expenses in a timely manner. However, in fact, the state treasury can provide significant

flexibility in managing funds. The department stated that it will explore depositing funds with the state treasurer as a possible option.

Introduction

Allegation

We received an allegation under the Reporting of Improper Governmental Activities Act (act) that an official of the California Cemetery Board (board) was involved in incompatible activities that conflicted with his state duties at the board. The complainant also alleged that the official breached his fiduciary duties when administering cemetery trust funds.

The Reporting of Improper Governmental Activities Act

The Bureau of State Audits administers the act, which is contained in Section 8547 et seq. of the California Government Code. The act defines an improper governmental activity as any activity by a state agency or state employee undertaken during the performance of the employee's official duties that violates any state or federal law or regulation; that is economically wasteful; or that involves gross misconduct, incompetence, or inefficiency. The Bureau of State Audits receives and investigates complaints of improper governmental activities. To enable state employees and the public to report improper governmental activities, the state auditor maintains a toll-free whistleblower hotline. The hotline number is (800) 952-5665.

—◆—
Whistleblower hotline:
(800) 952-5665
—◆—

The California Cemetery Board

Organizationally, the board is located in the Department of Consumer Affairs (department) and consists of six members appointed for four-year terms.¹ The official, who is responsible for enforcing the laws and regulations for cemeteries, crematories, and their representatives, was appointed by the board in April 1994. He is also responsible for administering trust funds under the jurisdiction of the board.

¹ Chapter 381, Statutes of 1995, transfers all of the duties, powers, purpose, responsibilities, and jurisdiction of the board to the department. The effective date of the law is January 1, 1996.

Trust funds are to be invested so that the income from the investment can be used for the specified trust purposes. After obtaining control of trust funds with a board order or court order, the board becomes the trustee of the funds. The California Probate Code requires a trustee to administer trust funds with the care, skill, prudence, and diligence that a prudent person would exercise to accomplish the purposes of the trust. In addition, the trustee is bound to act in the highest good faith toward the beneficiaries.

As of October 1995, the board controlled trust funds of varying amounts for 11 cemeteries. The largest trust fund was more than \$2 million. Table 1 lists the cemeteries whose trust funds are under the control of the board and the locations of the cemeteries.

Table 1

***Cemeteries With Trust Funds Controlled by the Board
As of October 1995***

Name of Cemetery	Location of Cemetery
Abbey Funeral Center	Orange County
Arlington Cemetery	Sacramento County
Elkin Property	Amador County
Hills of Peace (Verdugo Hills) Cemetery	Los Angeles County
Imperial Valley Memorial Park	Imperial County
Lincoln Memorial Park	Los Angeles County
Mountain View Cemetery	Fresno County
Oakview Memorial Park	Contra Costa County
Paradise Memorial Park	Los Angeles County
Seasons Cemetery	Contra Costa County
Sunnyside Cemetery	Los Angeles County

Scope and Methodology

To investigate the allegation, we reviewed state laws in the California Health and Safety Code, the Business and Professions Code, the Government Code, and the Probate Code. We also reviewed available trust documents and accounting records for the various cemetery trust funds under the control of the board.

In addition, we interviewed employees at the board and at the department. During the course of our review, the board took control of the trust funds for two cemeteries in Los Angeles County: Lincoln Memorial Park and Paradise Memorial Park. We did not conduct an in-depth review of these two cemetery trust funds because the department was reviewing them.

Chapter 1

Two Employees Engaged in Incompatible Activities

Chapter Summary

Legal prohibitions against incompatible activities exist to prevent state employees or state officers from being influenced in the performance of their official duties or from being rewarded by outside activities for any official actions. An incompatible activity, as defined in Section 19990 of the California Government Code, is any employment, activity, or enterprise that is clearly inconsistent, incompatible, in conflict with, or inimical to a state employee's or state officer's duties. Prohibited activities or enterprises include activities subject to the control, inspection, review, audit, or enforcement by the state officer or employee. Prohibited activities also include receiving any gift or any other thing of value from anyone who does, or seeks to do, business of any kind with the California Cemetery Board (board) or Department of Consumer Affairs (department) if it could reasonably be inferred that there was an intent to influence the officer or employee in the performance of his or her official duties or that there was an intent to reward an official action.


Nevertheless, two employees of the board engaged in incompatible activities.

An Official Engaged in Incompatible Activities


In violation of laws prohibiting incompatible activities, the official improperly accepted cash and employment from a licensee of the board. The official also made false representations and withheld information from us concerning a cemetery belonging to this licensee. Further, the official improperly told the licensee that the cemetery was excluded from statutory requirements. Moreover, although the official declined a gift of a deed to a cemetery from the same licensee, we question his motives because he did so after he became aware of our review of this area.

Improperly Accepted Cash and Employment

The official violated state law when he personally received \$10,237.66 from the president of the corporate owner of Arlington Cemetery. Because this owner is a licensee of the board for another facility in southern California, it is subject to control, inspection, review, audit, and enforcement by the board. The official is responsible for reviewing cemetery trust funds, licensing cemeteries and crematories, and enforcing state laws and board regulations, so state law prohibits him from accepting the money.




*State official illegally
accepted more than
\$10,200.*




In November 1994, Arlington Cemetery was purchased by a new owner. On December 29, 1994, after the purchase was completed, the official mailed a bank check for \$10,237.66 to the new owner. Before that date, the board held the money in trust funds for the cemetery and the official served as the trustee for the funds on behalf of the board. The \$10,237.66 was the remaining balance in the cemetery's trust account at the time of sale. The trust funds are to be invested so that the income earned will pay for the cemetery operations. After the president of the corporate owner received the bank check, he endorsed the check over to the official. The signatures of the president and the official appear on the back of the check.

False Statement Regarding Recipient of Endorsed Check

Originally, on June 5, 1995, the official told us under the penalty of perjury that the check was given to a religious organization. The official is the president of this organization, a nonprofit religious corporation, and his wife is a member of the organization's board of directors. However, in late November 1995, the official stated, once more under the penalty of perjury, that the cemetery owner gave the money to him and his wife as individuals. Although the official certified in writing under the penalty of perjury that each of the statements was true and correct, one is clearly false, and both may be false.



*Official made false
statement under penalty
of perjury.*



Reason for Accepting Funds

We asked the official why the cemetery owner endorsed the check over to him. He claimed that the owner transferred the funds to him as part of an oral agreement under which he and his wife would make improvements to the cemetery and automate its records. According to the official, there was no written agreement with the owner to perform work at

Arlington Cemetery. The official also stated that he agreed to do work at the cemetery because in early 1995, funding problems prevented him from knowing his future employment status with the board.

On January 17, 1995, using the funds he received from Arlington Cemetery's new owner, the official opened savings and checking accounts. Of the \$10,237.66, the official deposited \$9,737.66 into the savings account and the remaining \$500.00 into the checking account. Although the funds were trust funds, the official opened the account as a business account and not as a trust account. The signature card for the two accounts lists the official as the only authorized signatory for the accounts. In addition, although the accounts were in the name of the cemetery, the taxpayer identification number for the accounts was the official's Social Security number. The signatory card lists the official's mailing address as a post office box. The box is the mailing address for the religious organization mentioned earlier. Later, the bank mailed the bank statements to the official's personal residence.

As of July 31, 1995, the bank statements showed balances of approximately \$900 for the checking account and \$700 for the savings account. Although the official claimed that he used the money to improve the cemetery and its records, he wrote checks totaling more than \$5,800 out of the account to his wife, his personal creditors, the religious organization of which he is the president, and himself. He also wrote checks for \$400 to a charitable organization and for \$200 to an individual not connected with the cemetery. In a later section of the report, we will discuss the official's breach of his fiduciary duty for the trust funds.

False Representations Regarding Trust Funds

When the official transmitted the check to the new owner on December 29, 1994, he told the new owner in writing that the funds were neither endowment care funds nor special care funds. Both endowment care and special care funds are trust funds that must be invested to produce income. The income could then be used for the care, maintenance, and embellishment of the cemetery. In the same letter, the official told the new owner that the funds "are simply what was left after the former owner walked away."


However, the official's statement that the funds were simply leftover funds is false. These funds were trust funds that could be used only for the specific trust purposes. According to the trust instrument covering Arlington Cemetery's care fund, the

trust principal must be held in trust and invested to produce income that could be used for maintenance and other cemetery services.


The official told us that no one had ever determined what these funds were. However, the funds had consistently been held and treated as trust funds. For example, in 1967, the prior operator of Arlington Cemetery established a trust for monies it received from the sale of cemetery plots. According to the trust instrument, the principal of such funds must be held in trust and invested, and only the income from the trust principal can be used for cemetery operations. When the trust was established, a bank acted as trustee for the cemetery funds, but the board became the trustee when it accepted the trust funds in May 1986.

In addition, the funds were consistently called trust funds in correspondence from various parties, including the earlier cemetery owner, the Attorney General's Office, the banks, and the board. The official also received bank statements that described the funds as trust funds. For example, the bank statements for all of 1994 listed the board as trustee for the cemetery trust account.

Further, in discussions between the board and its official, the Arlington Cemetery funds were called trust funds. For example, in a late September 1994 board meeting, the board, the official, and the department's legal counsel discussed the trust funds for Arlington Cemetery. During that meeting, the legal counsel consistently described the funds as trust funds and explained that a court order would be necessary to use the corpus, or principal, of the trust. The official was present at that meeting.



*Official withheld
information regarding
trust funds.*



The official also withheld information regarding Arlington Cemetery and its trust funds from us. When we began our investigation of the board, the official did not disclose information about the funds to the investigators. Subsequently, after learning of the funds from independent sources, we requested from the official all information about Arlington Cemetery. The official stated that he had mailed all the original board records to the new owner in southern California. It is unclear why he would mail original board records to the new owner instead of copies. After receiving our request, the official offered to retrieve the records from the new owner. Later, he stated that he had obtained the records from the new owner. However, he supplied us with only limited information about the Arlington Cemetery funds. To obtain the missing records, we issued subpoenas to the bank that held the funds.

Improperly Excluded the Cemetery From Statutory Requirements

In a letter dated November 22, 1994, the official told the new owner that Arlington Cemetery was excluded from the provisions of the Cemetery Act. A part of the California Business and Professions Code, the Cemetery Act requires the board to license and oversee the operations of cemeteries and crematories. According to the official's statement, the cemetery could operate independently, without being licensed and regulated by the board. We believe that the official acted improperly by telling the new owner that the Arlington Cemetery was not subject to the legal requirements.

The official stated that because the property is less than ten acres and was established before 1939, it is excluded from the provisions of the Cemetery Act. In addition, he told us that the board's legal counsel had previously stated that he believed the board did not have jurisdiction over the cemetery. Moreover, the official stated that the board had given him strong indications that this was a property that should not come under the board's authority.

However, according to a legal opinion from the Legislative Counsel, the cemetery is subject to the Cemetery Act. The cemetery is located on two separate parcels in Sacramento County. One portion of the cemetery was established in the 1860s, the other in the 1960s. The combined area for both cemetery portions is approximately eight acres. Records indicate that the cemetery was operated as a nonendowment care interment property during the 1960s and 1970s. However, after March 7, 1973, following enactment into law of Chapter 1269, Statutes of 1972, the cemetery became subject to the Cemetery Act. This law added statutory language to make certain smaller, older private cemeteries subject to the Cemetery Act if they collected care, maintenance, or embellishment deposits. Arlington Cemetery collected such care deposits from plot purchasers and therefore became subject to the cemetery laws. Specifically, purchasers of cemetery plots signed agreements to deposit money into a care fund. These care funds were held in a trust account. As discussed earlier, under the terms of the trust, the income from these care trust funds was designated for the care and maintenance of the cemetery, whereas the trust principal was to be invested and held intact.

In July 1994, several months before his purchase of the cemetery, the corporate owner's president applied for and received board approval for matters related to another cemetery. However, we found no evidence that the actions of

the official were influenced by the acceptance of the cash and employment from the owner when his future employment status with the board was unknown. Further, we could not determine whether the owner intended to reward the official for his decision to exempt Arlington Cemetery from the laws and regulations of the board or to influence the official in the performance of his state duties.

Improper Offer of the Deed to the Cemetery

On April 29, 1995, the president of the new owner of the Arlington Cemetery signed a quitclaim deed that transferred the ownership of the cemetery to the aforementioned religious organization. As previously stated, the official is the president of the religious organization.

Although the official declined the gift of the deed, we question his motives because he did so only after he became aware that we were reviewing his handling of trust funds. Specifically, in a letter to the owner, dated May 3, 1995—one month after we began our investigation—the official's wife stated that she and her husband believed that the religious organization could not accept the cemetery because it would create a potential conflict of interest for the official and the religious organization to own cemetery property. She also told the owner that the board was being reviewed by the State and that we may be contacting him in the near future. We confirmed that, as of December 20, 1995, the quitclaim deed had not been recorded with the Sacramento County Recorder's Office.

According to the official, the owner tried to deed the property to the religious organization because the owner did not want to extend his business to northern California for personal reasons. The official also stated that the owner liked and trusted him and his wife. We attempted to interview the owner to determine the reasons why the owner wanted to transfer the ownership just six months after buying the cemetery. However, the owner declined to be interviewed by an investigator without the presence of the official.

Another Employee Engaged in Incompatible Activities

As we stated earlier in the report, Section 19990 of the California Government Code states that incompatible activities or enterprises are those subject to control, inspection, review, audit, or enforcement by the state officer or employee. They also include receiving compensation from anyone other than the

*Another employee
illegally accepted more
than \$3,800.*

State for performance of state duties. Nevertheless, another employee of the board accepted \$3,840 from July through September 1995 from a cemetery, Paradise Memorial Park, under the jurisdiction of the board. During this time, he also earned a state salary from the board as a part-time employee. The employee's duties for the State included inspecting cemeteries to verify compliance with licensing requirements and conducting investigations of complaints against cemeteries.

The board issued an order seizing the assets of the cemetery's endowment and operation funds in June 1995 and became the interim receiver for the cemetery in July 1995. Consequently, the activities of the employee for the cemetery were clearly subject to control, inspection, review, audit, and enforcement by the board.

Nevertheless, when the board took possession of the cemetery's trust fund and established new bank accounts, the official and the other employee each had signatory authority on the accounts. The employee then wrote eight checks to himself, using the trust funds. He wrote himself one check for \$960 and seven checks for \$320 each. In addition, the official wrote two checks to the employee that totaled \$640. The total amount of the checks was \$3,840.

According to the official, the president of the board reviewed and authorized the payments to the employee. However, writing checks to oneself violates the prescribed system of good internal controls that we discuss later in the report. Further, we could find no evidence that either the employee or the board withheld or paid payroll taxes on the payments made to the employee from the cemetery's funds. Furthermore, although the official implied that the employee had always been a part-time employee of the board, we found that the employee had worked full time for the board in the two months preceding July 1995. Consequently, the employee accepted payment from someone other than the State for performing his state duties.

In addition, according to the official, the superior court allowed the additional compensation to the field representative. However, contrary to the official's statement, we found no evidence that the court had authorized any payments to this state employee.

Chapter 2

The Official Breached His Fiduciary Duties Regarding Cemetery Trust Funds

Chapter Summary

The official acted improperly when he managed the cemetery trust funds under the control of the California Cemetery Board (board). Specifically, he illegally used one cemetery's trust funds, used portions of the trust fund's principal, and failed to designate the trust fund's assets as belonging to the trust. In addition, he generally failed to invest trust funds prudently, prepare required accounting documents, and follow prudent administrative procedures in handling the funds.

—◆—
Official was required to act in the highest good faith when administering trust funds.
—◆—

The California Probate Code requires that trust funds be administered with the care, skill, prudence, and diligence that a prudent person would exercise to accomplish the purposes of the trusts. Further, the trustee is bound to act in the highest good faith. A breach of trust is any act by a trustee contrary to the terms of the trust or in excess of his authority and to the detriment of the trust, or the wrongful omission by a trustee of any act required of him by the terms of the trusts. A breach of trust also includes the wrongful misappropriation by the trustee of any funds or property that had been lawfully committed to him in a fiduciary manner. Every violation by a trustee, whether willful and fraudulent, done through negligence, or arising through mere oversight and forgetfulness, is a breach of trust. A breach includes every omission and commission in carrying out the trust according to its terms and any violation of care and diligence in protecting and investing the trust property.


Breach of Duties Regarding Arlington Cemetery Trust Funds

As stated earlier, the owner of the Arlington Cemetery gave the official \$10,237.66 of trust funds. The official then opened two bank accounts for the cemetery and illegally used the funds. Further, he illegally used the trust fund's principal and failed to designate the trust's property as belonging to the trust. As a result, the official breached his fiduciary duties as a trustee of the funds.


Illegally Used Trust Funds

The Probate Code, Section 16004, states that the trustee has a duty not to use or deal with trust property for the trustee's own profit or for any other purpose unconnected with the trust. The trustee's duty is to carry out the terms of the trust according to the expressed intent of the trust instrument. However, the official used the trust funds for his own profit and for other purposes not connected with the trust.

Specifically, a review of the bank expenditures from January 17, 1995, when the official opened the accounts, through July 31, 1995, showed that the official and his wife wrote checks and took cash back from deposits totaling \$6,426 from the trust funds for illegal and improper expenditures. Seven checks for a total of \$3,494 were written to either the official or his wife. The official also took \$250 in cash back from a deposit into the account. According to the official, all payments to him and his wife were payments for services or reimbursement for the cemetery's expenses.



Official used trust funds for his personal benefit, including \$1,482 to personal creditors.



Using trust funds, the official also wrote nine checks to his and his wife's personal creditors. The total of the nine checks was \$1,482. Three checks, totaling \$1,000, were written to three different credit card companies. In addition, one check for \$200 was written as a payment for a personal line of credit. Another check, for \$25, was written for child care. Yet another check, for more than \$52, was for cleaning clothes. Finally, the official wrote three checks totaling \$205 to a telephone company. The checks were for a private, unlisted telephone number at the residence of the official and his wife. Under the penalty of perjury, the official stated, "In lieu of paying ourselves for our services, we often wrote checks directly to a vendor for personal bills."

In addition, the official wrote two checks totaling \$400 from the trust funds to a charitable organization. He described one \$200 payment as a business donation for the organization's Easter egg hunt. The remaining \$200 was listed as a donation. Further, the official wrote two checks totaling \$600 to the religious organization of which he is the president. The one check for \$100 is described as a donation. According to the official, the other check, for \$500, was reimbursement to the organization for expenses.

Moreover, the official wrote a check for \$200 to an individual. He described the individual as a proctor for a licensing examination in southern California for the board. According to the official, he wrote the check from the Arlington Cemetery funds because the board was closed and the individual lived on

a fixed income. However, other records show that the \$200 was a gift. Further, it is illegal to use a cemetery's trust funds to pay the State's liabilities.

Table 2 summarizes the illegal and improper payments from the Arlington Cemetery trust funds from January 17, 1995, the date the official opened the accounts, through July 31, 1995.

Table 2

***Summary of Illegal and Improper Expenditures
From the Arlington Cemetery Trust Funds***

Official gave \$600 of trust funds to his own religious organization.

Type of Payments	Amount
Payment to official and his wife	\$3,744
Payments to creditors of the official and his wife	1,482
Charitable organization	400
Religious organization controlled by the official and his wife	600
Payment to individual	200
Total	\$6,426

Illegally Used the Trust's Principal

Section 16000 of the California Probate Code states that the trustee has a duty to administer the trust according to the trust instrument and according to Probate Code. The trust instrument, created in 1967, clearly states that the trust principal shall be held in trust and invested. The trust document also states that only the income from the trust can be used for the cemetery operations. In addition, Section 16006 states that the trustee has a duty to preserve the trust property. Nevertheless, after opening the two bank accounts with the trust funds totaling \$10,237.66 for the Arlington Cemetery, the official used most of the trust principal illegally. Further, he did not obtain a court order authorizing the use of the trust principal. The bank statements showed that only \$1,600 of the trust funds remained as of July 31, 1995.

The official should have known that the trust principal for Arlington Cemetery could not be used without a court order. As we reported earlier, the Department of Consumer Affairs' (department) legal counsel told the official in a September 1994 board meeting that only a court order could authorize the use of

the trust principal. In addition, the official himself told us that it was improper for anyone or any entity to use a trust's principal to operate a cemetery without court authorization.

Failed To Identify Assets as Belonging to the Trust

Although required to do so by the Probate Code, Section 16009, the official did not designate the trust funds for Arlington Cemetery as trust funds when he opened the bank accounts. As stated earlier, he told the bank that the funds were business accounts. Moreover, the official used his personal Social Security number as the taxpayer identification number on the accounts.

The official claimed that the check for \$10,237.66 that the owner of the cemetery endorsed over to him was not really the trust funds but other funds belonging to the new owner. He claimed that the owner merely endorsed the check from the board over to the official out of convenience so that the owner would not have to withdraw other monies and pay fees. The official also claimed that the owner had set aside separate funds in his own account that represented the funds that the board had transferred to him after purchasing the cemetery. To support his claim, the official provided us with a copy of a statement from a securities account. This account showed a limited partnership investment with a face value of \$25,000. The actual value of the limited partnership is not shown on the statement. However, the statement does not show the cemetery owner on the account. Instead, the statement shows the president of the corporation, as an individual, and his wife as the owners of the account. In addition, the statement does not designate the funds as trust funds for Arlington Cemetery.

Breach of Duties Over Trust Funds in General

As stated earlier, the cemetery board had custodianship of trust funds belonging to 11 cemeteries as of October 1995. In addition to the official's breaches of duty described above, he also breached duties related to other trust funds under his control.

Failed To Invest Funds Prudently

The official did not prudently invest some trust funds to earn interest income. Specifically, although the California Probate Code, Section 16007, states that a trustee has a duty to make

the trust property productive, the official often invested trust funds in noninterest- or low-interest- bearing accounts. In addition, as stated earlier, the same code requires the trustee to act with the care, skill, prudence, and diligence that a prudent person acting in a like capacity would use when investing and managing trust assets.

We identified seven bank accounts under the control of the official that earned no interest income, two accounts that earned less than 2 percent interest, and two accounts that earned approximately 2.5 percent on the invested funds. Table 3 shows examples of bank and savings and loan accounts controlled by the official that had balances in excess of \$1,000 but that earned no- or low-interest rates.

Table 3

***Interest Rates Earned on Accounts With Balances in Excess of \$1,000 and Controlled by the Official
As of March 31, 1995***

More than \$44,000 in trust funds were deposited in accounts that earned no interest.

Name of Cemetery	Account Balance	Rate of Interest (Percent)
Abbey Funeral Center	\$254,000	3.30%
Arlington Cemetery	1,000	0.00
Arlington Cemetery	4,300	3.30
Elkin Property	28,200	0.00
Hills of Peace (Verdugo Hills) Cemetery	8,700	1.00
Hills of Peace (Verdugo Hills) Cemetery	67,200	4.00
Hills of Peace (Verdugo Hills) Cemetery	11,600	4.02
Hills of Peace (Verdugo Hills) Cemetery	6,700	2.57
Mountain View Cemetery	6,200	0.00
Mountain View Cemetery	7,500	3.73
Mountain View Cemetery	2,900	0.00
Oakview Memorial Park	44,900	3.15
Oakview Memorial Park	12,300	2.55

Name of Cemetery	Account Balance	Rate of Interest (Percent)
Oakview Memorial Park	2,900	1.06
Sunnyside Cemetery	3,200	0.00
Sunnyside Cemetery	1,300	0.00
Sunnyside Cemetery	1,400	0.00
Sunnyside Cemetery	3,000	3.39

In contrast, if the official had deposited the trust funds with the state treasurer, the trust funds would have earned a higher rate of interest. We discuss the official's failure to deposit funds with the state treasurer later in the report. Specifically, in fiscal year 1994-95, the treasurer earned an average rate of interest of 5.532 percent on the pooled money investments. During this fiscal year, the interest rate paid on invested funds ranged from a low of 4.823 percent to a high of 6.008 percent.

Official knew his responsibility but did not fulfill it.

When we asked the official about his investment policy, he stated that an important activity when administering trust funds is to invest the assets in a prudent manner. Further, he stated that it would be imprudent to invest funds in a bank account earning 2 percent interest when the funds could be invested to earn higher interest rates in bonds or a certificate of deposit. Although the official appears to understand his fiduciary responsibility in this area, he clearly did not fulfill it.

In addition to investing funds in no- or low-interest rate accounts, the official failed to invest \$5,000 of trust funds from Hills of Peace (Verdugo Hills) Cemetery. The \$5,000 represented funds from a debenture (bond) that matured in September 1992 but was not redeemed. If the bond had been redeemed when it matured and the proceeds invested with the state treasurer, the proceeds would have produced interest earnings of \$840 as of the end of November 1995. As stated earlier, the official was not appointed until April 1994. Further, according to the official, he believed the matured bond was still earning interest income. However, when managing the assets for a trust, the trustee has the responsibility of understanding the nature of the investments under his control. We believe that he should have been aware that the bond was not producing interest income and taken appropriate action to ensure that the trust funds were invested productively.

Further, contrary to the good cash management practice of maximizing interest earnings, the official often was slow to deposit checks into bank accounts to earn interest income. Although the amounts were small, the official's failure to promptly deposit these funds demonstrates a lack of effective management over the trust funds. For example, when reviewing the board's records in November 1995, we found a check for \$159 dated February 1, 1995. The official failed to deposit this check for more than nine months. Similarly, the department located other checks that the official failed to deposit promptly. According to the official, incoming checks often were put aside to be deposited later because of the heavy workload at the board. He added that the board was forced to deal with issues more pressing than depositing checks.

Failed To Prepare Required Accounting Documents

Although the Probate Code and good accounting practices require the trustee to prepare an accounting of the trust funds, the official failed to do so. Section 16062 of the Probate Code requires a trustee to prepare an accounting of trust funds at least annually. Section 16063 describes the required accounting statements, which include a statement of receipts and disbursements of principal and income and a statement of assets and liabilities of the trust as of the end of the reporting period. In addition, good accounting and management practices require that financial statements for an entity, such as a trust, be prepared at least annually.

During our review of the board's records, we found statements of assets and liabilities as of December 31, 1994. Later, we learned that the board did not prepare these statements. According to the department's former internal auditor, these statements are in no way official statements, but the auditor's attempts to make sense of the limited and chaotic board information. The former internal auditor also stated that the official never prepared any accounting statements.


We also found financial statements for Imperial Valley Memorial Park prepared by the bank holding the funds. However, we found no other statements of receipts and disbursements for any of the trust funds for the year ending December 31, 1994. Without such accounting information, the official and the board were limited in their management of the trust funds.

Also, contrary to a court order, the board failed to submit an accounting of the trust funds for Hills of Peace (Verdugo Hills) Cemetery with the Los Angeles County Superior Court. In


establishing the conservatorship for this cemetery trust fund, the court ordered the board to prepare an accounting of the assets, liabilities, income, and disbursements every two years and submit it to the court. An accounting of the trust funds was due in March 1994. However, we could not locate the accounting of the trust funds. Although the official was not appointed to his position until April 1994, as trustee he should have determined that the board had not submitted its required accounting to the court and taken prompt action to comply with the court order.

Failed To Follow Prudent Administrative Procedures on the Trust Funds

The Probate Code, Section 16006, states that a trustee has a duty to use reasonable steps to take and keep control of trust property. The code also states that the trustee has a duty to preserve trust property. However, the official used poor administrative procedures when administering the trust funds. For example, the official did not regularly prepare reconciliations of bank accounts to the board's records. The department reported that the board had not reconciled bank accounts for several trust funds for many months. For example, as of mid-October 1995, the seven bank accounts for Paradise Memorial Park had not been reconciled since July 1995. In addition, as of mid-November 1995, the bank accounts for Hills of Peace (Verdugo Hills) Cemetery and the Elkin Property had not been reconciled since June 1995. Further, the bank accounts for Mountain View Cemetery had not been reconciled since May 1995 and the accounts for Oakview Memorial Park had not been reconciled since December 1994. The department is reconciling all the bank accounts for the trust funds.





Trust accounts were not reconciled.



Reconciliations are prudent accounting and management tools to improve the accuracy of the records and to identify errors in the bank accounts and the board's records. Reconciling accounts ensures a careful review of all cash transactions and provides a means for proving the accuracy of the board's records. Reconciliations are valuable because they allow a comparison of two independent sources that have recorded the same transaction. When any differences are identified, they should be examined and, if necessary, corrected.



During our review, we also found that the official stored valuable and important documents in a file folder in an unsecured area of the board's office. The documents included three bond certificates with a face value of \$15,000, savings passbooks, and certificates of deposits. At a minimum, valuable

and important trust documents should be stored in a locked cabinet in a secured area.


Trust account statements were mailed to official's home.


In another example of poor administrative procedures, bank statements were mailed to the official's home address rather than to the board's address. Specifically, bank statements for Arlington Cemetery, Sunnyside Cemetery, Abbey Funeral Center, and Mountain View Cemetery were mailed to the home address of the official. In addition, at least two statements were mailed to the post office box of the official's religious organization. Because these bank statements are state property, they should be mailed to the board's office. According to the official, the mailing of bank statements to his home was an error by the banks. He added that he often signed blank signatory cards at the banks and that may explain why the statements were incorrectly mailed to his home.

The Financial Integrity and State Manager's Accountability Act requires the head of each state agency to establish and maintain an adequate system of internal controls within his or her agency. Internal controls are designed to prevent errors, irregularities, or illegal acts. As a result, the maintenance of a strong system of internal controls is critical to fulfilling the fiduciary responsibilities of a trustee. However, the board had almost no internal controls over the bank accounts containing the trust funds.


Official had sole signatory responsibility over many trust accounts.


Generally accepted principles of internal controls prescribe that duties be separated so that one person's work routinely serves as a check on another person's work. The separation of duties ensures that no one person has complete control over more than one key function, such as authorizing, approving, certifying, disbursing, receiving, or reconciling. However, there was a lack of separation of duties for the bank accounts because the official controlled several key functions over the accounts: the authorization, approval, disbursement, and reconciliation of the transactions. Further, he did not separate the security and custody of the account from the recording and accounting functions. For example, he had sole signatory authority over many bank accounts. In addition, the official maintained the few accounting records for these trust funds. As a result, he authorized transactions that were improper and inconsistent with his duties as a fiduciary for the trust funds, including the transactions discussed earlier in this report. We also found that the official allowed another employee of the board to write eight checks totaling \$3,200 to himself. This practice is a further violation of the principle of separation of duties.

Finally, the official did not deposit trust funds with the state treasurer as required by Section 16305.3 of the

California Government Code. This law requires that all state money be deposited in trust with the state treasurer except when authorized by the Department of Finance. The trust funds are state money because the board possesses the funds and collected funds for the trusts. However, instead of depositing the trust funds with the state treasurer, the official deposited them in various bank accounts. As mentioned earlier in the report, the department stated that the size of each of the trust funds varied, with one trust totaling more than \$2 million for the 11 cemeteries under the board's control. If the trust funds had been invested with the state treasurer, many of the abuses described in this report would not have occurred because the State has established a system of internal controls.

Conclusion

Two California Cemetery Board (board) employees engaged in incompatible activities that conflicted with their state duties. Specifically, a board official accepted more than \$10,200 from a licensee of the board who was subject to board regulation. The official also made false representations and withheld information from us concerning a cemetery that belonged to the licensee. Further, he improperly told the licensee that the cemetery was excluded from statutory requirements. Moreover, although the official declined a gift of a deed to a cemetery from the same licensee, we question his motives because he did so after he became aware that we were reviewing his handling of trust funds.

We also found that another board employee engaged in incompatible activities when he accepted \$3,840 from a cemetery under court-ordered receivership.

Moreover, the official breached his fiduciary duties for cemetery trust funds. Specifically, he acted illegally and improperly when administering trust funds for Arlington Cemetery. His breach of trust at this cemetery included spending trust funds for illegal and improper purposes, spending the trust's principal without court authorization, and not designating property as trust property. He failed to invest other cemetery trust funds prudently and failed to prepare accounting documents, both required by law. Further, he failed to follow prudent administrative procedures when investing cemetery trust funds.

We conducted this investigation under the authority vested in the state auditor by Section 8547 of the California Government Code and in compliance with applicable investigative and auditing standards. We limited our review to those areas specified in the scope of this report.

Respectfully submitted,

A handwritten signature in cursive script, reading "Kurt R. Sjöberg".

KURT R. SJOBERG
State Auditor

Date: January 17, 1996

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Agency Response

The Department of Consumer Affairs (department) has taken the following corrective actions:

- Because the statutory authorization for the official's position ended January 1, 1996, the department terminated his position as of that date and will not offer him another position.
- The department will continue its investigation into the official's and his wife's personal use of Arlington Cemetery trust funds in cooperation with other law enforcement agencies and will seek criminal action if appropriate.
- The department will recover misused Arlington Cemetery trust funds either through criminal or civil actions.
- The department will refer conflict of interest issues to the Fair Political Practices Commission.
- The department terminated the other employee's limited-term appointment and will explore recovering payments made to him as appropriate.
- The department will assure that payments to the other employee are properly reported to taxation authorities.
- The department has gained control of the majority of the trust funds, has reconciled accounts, is preparing an investment strategy, and has established systems of internal control over the accounts, including separating the various duties related to administering the funds.
- The department does not agree that the trust funds must be deposited with the state treasurer. As stated in the report, if the department obtains permission from the Department of Finance, it can deposit the funds outside the state treasury. The department also is concerned whether depositing funds in the treasury will afford the flexibility necessary to disburse funds for appropriate cemetery expenses in a timely manner. However, in fact, the state treasury can provide significant flexibility

in managing funds. The department stated that it will explore depositing funds with the state treasurer as a possible option.

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps